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IN THE

Supreme Court of the United States

OCTOBER TERM, 1968

No. [redacted] 152

TRUST COMPANY OF GEORGIA, Executor Under the Will of Carling Dinkler, Sr.; CARLING L. DINKLER, JR., and CORNELIA V. DINKLER; and TRUST COMPANY OF GEORGIA, Executor Under the Will of C. L. Dinkler, Sr., and MRS. JOEL W. DINKLER, Surviving Wife,

Petitioners,

v.

AUBREY C. Ross, District Director of Internal Revenue,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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v.

AUBREY C. ROSS, District Director of Internal Revenue,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered in the above-entitled case on December 20, 1967.

CITATIONS TO OPINIONS BELOW

The opinion of the Court of Appeals, printed in Appendix A attached to this petition, *infra*, pp. A1-A5, is reported in ____ F2d ____. The opinion of the United States District Court for the Northern District of Georgia, printed in Appendix A, pp. A7-A28, is reported in 262 F. Supp. 900.

JURISDICTION

(i) The judgment of the Court of Appeals was entered on December 20, 1967 (R. Vol. III, 301).

(ii) Rehearing was denied on March 7, 1968. (R. Vol. III; 375).

(iii) The jurisdiction of this Court is invoked under 28 U.S.C.A. Sect. 1254(1).

QUESTION PRESENTED

Do the proceeds of a sale of stock pursuant to a conditional executory contract signed by a decedent prior to his death and ultimately performed by his executor, after having been amended subsequent to the decedent's death, constitute income in respect of a decedent within the meaning of Section 691 of the Internal Revenue Code of 1954?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are: Internal Revenue Code of 1954, Sections 691 and 1014; Treasury Regulations, Sections 1.691(a)-1, 691(a)-2. The relevant parts of these sections are printed in Appendix B, *infra*, pp. B1-B5.

STATEMENT

Carling Dinkler, Sr., individually, Carling Dinkler, Sr., as Trustee for Carling Dinkler, Jr., Carling Dinkler, Jr., individually, and Dinkler Hotels Company, Inc., entered on August 4, 1960, into an executory contract to sell substantially all of the assets and properties comprising the Dinkler Hotel chain to Associated Hotels Corporation, a Delaware corporation. The properties which were the subject of the executory contract to sell consisted of all of the stock of Dinkler-Tutwiler Corporation and Dinkler-Forsyth Corporation, and all the assets of Dinkler Hotels Company, Inc., including all of the stock of Dinkler Tutwiler Operating Company, Inc., Andrew Jackson Operating Company and Hotel Dinkler Plaza Operating Company, the latter owning all of the stock of Belvedere Corporation.

The Purchaser was organized only two days before the contract was signed and had paid-in capital of only $45,000. The sales price, as subsequently adjusted pursuant to the terms of the contract, was $11,207,959, of which $4,492,959 was to be paid by demand notes at the closing and the balance of $6,715,000 in cash. (R. Vol. II, 145). Of this cash, $500,000 was earnest money deposited by the Purchaser, $300,000 on the signing of the contract and $200,000 on December 20, 1960, when the closing date was extended from January 3, 1961 to a date no later than March 1, 1961. This left a balance of $6,215,000 for Associated Hotels Corporation to produce at closing.

Included among the assets to be sold was the Dinkler-Tutwiler Corporation stock, all owned by Carling Dinkler, Sr., at the contract price as adjusted of $3,539,948 (R. Vol. I, 47). It is the taxability of the gain from this sale, which took place after Mr. Dinkler's death, that is in issue here.

In the event of a default by the Purchaser the contract provided that it would be liable only for liquidated damages in the amount of the earnest money deposited by it. Section 3 of the contract contains the following provision on this point:

> ". . . in the event that the Buyer shall default in the performance of any of its obligations under this Agreement, then the Escrow Agents shall redeliver the stock certificates and stock powers to the respective Sellers from whom they were received and the Sellers shall retain all payments of the purchase price theretofore made as liquidated damages." (R. Vol. II, 11).

The liquidated damages on default of Purchaser, which had a limited paid-in capital of $45,000 and no operating experience, would have been $500,000, already escrowed, to the entire group of Sellers. In contrast, to close it was

required to pay in cash $6,215,000, $2,000,000 of which was loaned to Purchaser under unusual circumstances by the bank which was Executor of the Dinkler Estate and the Estate itself. Mr. Dinkler's share of the liquidated damages on account of his Dinkler-Tutwiler Corporation stock would have been a little less than a third (31.6%) of the $500,000. Moreover, the Purchaser would not have been liable for even liquidated damages if the Sellers had failed to perform any one of the numerous conditions precedent to the consummation of the sale.

The executory contract, reprinted in full in the record (R. Vol. II, 6-34), contained many such conditions. Among these were (1) that all of the assets and properties must be free and clear of all liens and encumbrances (with certain specified exceptions) as of the closing date, (2) the stock certificates, deeds, bills of sale and releases required to pass title had to be delivered at closing, and (3) an opinion of counsel for the Dinklers, dated the closing date, was to be delivered as to the corporate existence and good standing of each of the corporations; requisite corporate action authorizing the sale of assets by the corporate seller; marketability and freedom from liens of the properties owned by each corporation; absence of judgments, suits, proceedings or investigations which might materially affect the business, assets, prospects or condition of the several corporations; and the absence of any default by any of the corporations under any other contract or indenture.

All of these conditions were unperformed on January 30, 1961, the date of the death of Carling Dinkler, Sr. Additionally, the consents of mortgagees holding large mortgages on the hotels in Birmingham and Atlanta had to be secured, and these consents had not been given by the mortgagees as late as February 10, 1961 (R. Vol. II, 154).

Also, regardless of the performance or nonperformance of the conditions, neither party would have been liable if the Dinkler Plaza Hotel in Atlanta had been taken in condemnation or destroyed by casualty, including fire, at any time before the closing.

Either party could terminate the unperformed contract to sell under the following circumstances as provided in Section 17:

> "In the event that prior to the closing there is a total loss of the Dinkler Plaza Hotel by casualty (including fire), whether or not compensable by insurance, or condemnation, then any party on notice to the other parties may elect to cancel this Agreement within ten days of such loss in which event all obligations of the parties (except with respect to the return of amounts paid by the Buyer) shall cease and terminate." (R. Vol. II, 33).

Of the $6,215,000 needed in cash (other than earnest money of $500,000) for the closing, the Purchaser on the date of Mr. Dinkler's death was short $2,350,000, or 37.8%. Equitable Life Assurance Society, the mortgagee of the Dinkler Plaza Hotel which was owed a balance of $1,400,000 (R. Vol. I, 120), had earlier refused to lend Associated this amount (R. Vol. I, 120).

Before Mr. Dinkler's death, Associated had discussed a loan at 15% interest (R. Vol. I, 123) with secondary sources. The officers and owners of Associated "had never sought these secondary sources before in any" of their financing of other transactions (R. Vol. I, 123).

After extensive negotiations the Trust Company of Georgia agreed to lend Purchaser $2,000,000, this constituting 32.2% of the cash funds needed by it to close the transaction. Of the $2,000,000, $500,000 was loaned to Associated by the Trust Company of Georgia as Executor

of the Estate of Carling Dinkler, Sr., and the remaining $1,500,000, the bank's then limit, was loaned by its Commercial Department. In regard to the $500,000 loan by the Executor, Carroll P. Jones, then a Senior Vice President of the Trust Company of Georgia with thirty years of experience and now Vice President and General Trust Officer, testified:

> "In fact, this is the only one [time] I have even [sic] participated in a loan to buy something from the very seller you represent." (R. Vol. I, 103).

Mr. Jones explained that one reason for the Estate's participation in the loan to the purchaser of the assets from the Estate was because "suddenly we found ourselves facing the responsibility as an executor of the ownership of a very big hotel chain." (R. Vol. I, 105).

Augustus H. Sterne, a Senior Vice President of the Trust Company of Georgia at the time of the loan and now its President, said that "the interest of the bank as executor of Mr. Dinkler's Estate was a compelling factor in the consideration" of the $2,000,000 loan (R. Vol. I, 95-96). Also, he testified that the bank did not seek the participation of other banks in the loan because he did not "really think it was a saleable piece of merchandise" (R. Vol. I, 95) and was not "of a high enough degree in my opinion to warrant our going and asking a correspondent to join us in making the loan." (R. Vol. I, 97-98).

The Commissioner of Internal Revenue held that the proceeds from the sale of the Dinkler-Tutwiler stock constituted income in respect of a decedent under Section 691 of the Internal Revenue Code of 1954, and further held that long term capital gain in the amount of $3,454,-863.56 was realized on the sale and that said gain was taxable to Petitioners. In a suit for refund under Title 28, U.S.C., Section 1346(a)(1), the United States District

Court for the Northern District of Georgia so held. This decision was affirmed by the United States Court of Appeals for the Fifth Circuit.

The Fifth Circuit held that the District Court reached its conclusion by applying the wrong test, i.e., "whether the post death payments are in fact due to the services performed by or the economic activities of the decedent", but that the result was correct because the decedent was "entitled to the income at the date of his death."

REASONS FOR GRANTING THE WRIT

I. The Fifth Circuit's Decision Creates Income Where None Existed at Decedent's Death and Subjects to Income Taxation Unrealized Enhancement in the Value of Property Never Before Brought Within the Purview of Income Taxation.

A. *Court of Appeals' Decision in Conflict with Distinction Between Property and Income.*

The series of positions taken by the Treasury Department on this subject during the 34 years since the first legislation—Section 42, Revenue Act of 1934—was passed have expanded the law beyond the intention of Congress and the language of the statute itself. Under this creeping process it took the Department 30 years to reach the position, applied in this case for the first time, that a capital gain based upon the existence of an unperformed executory contract to sell was "income in respect of a decedent" where the contract was first amended and then performed by the decedent's executor after the decedent's death. Thus it has reached the unsupportable position that income includes not only "items of gross income" as prescribed by § 691 but also items of property such as a right in an executory contract to sell.

The entire history of the pertinent legislation shows that Congress was concerned only with items of income,

enacting § 42 of the Revenue Act of 1934 to relieve the discrimination of taxing accrued income to a decedent on the accrual basis and not to one on the cash basis. After the Supreme Court in *Helvering v. Enright,* 312 U.S. 636 (1941) and *Pfaff v. Commissioner,* 312 U.S. 646 (1941) defined "accrued" as used in § 42 more broadly than previously used in an accounting sense, there was often an unfair bunching of such "accrued" income in a decedent's final prior-to-death computation period. Solely to remove this inequity § 126 of the Internal Revenue Code of 1939, same as § 691 for purposes of this case, was enacted to replace § 42. This relieved the bunching by taxing such income to the person—executor or beneficiary—actually receiving it in the year of receipt. There is no indication whatever in the Committee Reports or in the language of the statute itself that "items of gross income" was intended to include anything other than such "amounts [of income] accrued" up to the time of death as set forth in § 42 and defined in *Enright* and *Pfaff*. On this point *Merten's Law of Federal Income Taxation,* Code Commentary Volume, Section 691.3, is in full accord, such section providing in part as follows:

> "Under prior law it appeared to be generally held in the case of the sale of property that the sale had to occur prior to the decedent's death or the income arising from the sale would not be treated as income in respect of a decedent . . . . the precedents under the prior law would appear to have application under the new Code in determining what constitutes income in respect of a decedent where the sale of property is involved."

Both the House and Senate Committee Reports state that Section 126 was intended to tax income accrued up to the date of a decedent's death, as called for by Section 42, but they also state that Section 42 was changed to provide that such amounts should be taxed not in a de-

cedent's prior-to-death return but in the hands of the persons receiving such accrued income. The House Report is as follows on this point:

> "Since the Revenue Act of 1934 the revenue laws have contained provisions including in the income of a decedent for a period in which falls the date of his death all *income accrued* up to the date of his death not otherwise properly includible in respect of such period or a prior period. While *such income* should be subject to income tax, hardship results in many cases from including in the income for the decedent's last taxable period amounts which ordinarily would be receivable over a period of several years. This section changes the existing law by providing that *such amounts* shall not be included in the decedent's income but shall be treated, in the hands of the persons receiving them, as income of the same nature and to the same extent as such amounts would be income if the decedent remained alive and received such amounts." (Emphasis added). H.R. Rep. No. 2333, 77th Cong., 2d Sess. 83 (1942).

The income tax has never been applied to appreciation in value of property until such appreciation has been converted into "income" or gain by reason of a sale or exchange of property. This basic principle is recognized in Section 1014(a) of the Internal Revenue Code, which provides that "the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall . . . be the fair market value of the property at the date of the decedent's death . . ." If, and only if, the property passed from the decedent "constitutes a right to receive an item of gross income in respect of a decedent" does this rule not apply. Int. Rev. Code of 1954, § 1014 (c).

Mr. Dinkler's estate received from him at death, not "a right to receive an item of income," but property (stock of Dinkler-Tutwiler Corporation), subject to an unperformed, conditional, executory contract to sell, many of the conditions of which were unperformed and unperformable as of the date of the decedent's death.

The Fifth Circuit disregarded this time-honored distinction between *property* and *income* in holding that the proceeds of the sale of Mr. Dinkler's stock, when consummated by his executor after his death, was an item of income taxable to his estate and its beneficiaries under Section 691. The cases cited in support of its decision, except *Commissioner of Internal Revenue v. Linde*, 213 F.2d 1 (9th Cir. 1954), cert. den. 348 U.S. 871, all deal with income from personal services rendered prior to death or with rents due and owing as of the date of death. In *Linde* a sale or its equivalent had been made under local law by the decedent prior to death and only an account receivable undetermined in amount existed in favor of the decedent's estate. "No act or thing taken or performed" by the executor operated in that case "to give rise" to the payment in question. 213 F.2d at 4. At the date of the decedent's death, the grape crop had been delivered beyond recall, there were no unperformed conditions and no closing was required.

No case cited by the Fifth Circuit supports its holding in the instant case that an unperformed, conditional, executory contract to sell stock gives rise to income merely because it was entered into by a decedent prior to his death.

B. Keck Based on Economic Activities Test Rejected by Court of Appeals.

Keck v. Commissioner, 49 T.C. No. 31 (1968), decided by the Tax Court without knowledge of the Court of Appeals' decision in this case (R. Vol. III, 328), simply com-

pounds the error of the case at bar since the majority of a sharply divided Tax Court "strongly relied" upon the "economic activities" test of the District Court which test the Court of Appeals has now rejected. *U. S. Tax Week,* commenting on *Keck,* emphasized this point and the failure of both the Tax Court and the Fifth Circuit to apply Example (4) of the Regulation, saying:

> "Apparently, the Tax Court did not yet have available the opinion of the Fifth Circuit in *Trust Co. of Ga. v. Ross,* CA 5, 12/20/67, 1968 USTW 130, aff'g 262 F. Supp. 900 (N.D. Ga., 1966). Although it affirmed the result reached by the district court, the Fifth Circuit specifically disapproved the 'economic activity test' used there. Instead, it approved a test which looks to whether or not the decedent has a 'right to receive the income' at the time of death.
>
> * * *
>
> "Although the regulations are by no means the last word on interpretation of the tax laws, it seems strange that the majority in *Keck,* as did the Fifth Circuit, failed to even mention the regulation, cited in the dissent, which acknowledges that the statute does not apply to the typical stock purchase agreement effective upon death, even though the price formula was fixed in the agreement before death. Reg. § 1.691 (a) 2(b), Example 4 (R&J § 54.12(5))" 17 U.S. Tax Week 197, 199-200 (1968).

If the economic activities test, applied in *Keck* by the Tax Court and in the instant case by the District Court, were sound, the distributees of every decedent's estate would be compelled to take the decedent's tax basis for the purpose of determining income realized from the sale or other disposition by the distributees of every asset received from a decedent, where the decedent had engaged in any such activities, e.g., negotiations, prior to death.

Such a result was clearly not contemplated by Congress in the enactment of Section 691.

C. Court of Appeals' Failure to Apply Supreme Court Cases as to when Gain is Realized.

As early as 1919, this Court correctly defined "gain" from a capital investment. *Eisner v. Macomber,* 252 U.S. 189 (1920). At page 207, Mr. Justice Pitney said:

> "The Government . . . placed chief emphasis upon the word 'gain', which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived. *'Derived-from-capital';*—'the *gain-derived-from-capital,'* etc. Here we have the essential matter: *not* a gain *accruing to* capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in,* being *'derived,'* that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal;—*that* is income derived from property. Nothing else answers the description." (Court's emphasis.)

This language is consistent with the "entitlement" or "right to income" test *pronounced* but *incorrectly applied* by the Fifth Circuit in the instant case.

The record is devoid of any facts to support the Fifth Circuit's statement that the decedent, upon signing the contract to sell his stock, became entitled to or had a right to the income or gain eventually realized by the Executor on the sale of the stock. The facts as determined by the District Court negate such a proposition. That Court did not apply the right to income test, but rather relied upon the so-called economic activities test, finding that by reason of his activities and efforts income was produced or earned by the decedent prior to his death.

It is acknowledged that many conditions to Mr. Dinkler's obligations and to the obligations of the Purchaser remained unfulfilled until closing (Appendix A, p. A26),. Indeed, at least one such condition, completely ignored by both the Fifth Circuit and the District Court, which gave an avenue of escape to either side, was impossible of performance until the day of the actual sale, namely, the conditional termination of the contract, without liability, by either party in the event of destruction or condemnation of the Dinkler Plaza Hotel.

The Fifth Circuit holds (Appendix A, p. A4), that the entitlement test "has reference to the date of death of the decedent." It then simply states that the contract "created a right to these proceeds in Mr. Dinkler at the time the contract was executed." He had a "right" to the proceeds only if all of the conditions precedent to his obligations and those of the Purchaser were performed; if the Purchaser did not default in payment of the purchase price (as it almost did); if the Dinkler Plaza Hotel remained undamaged and intact until closing; and if no liens or encumbrances arose or were asserted materially affecting the value of the property to be conveyed—all of these "ifs" having reference *not* to the *date of the decedent's death,* but to the *closing date.*

In *Lucas v. North Texas Lumber Company,* 281 U.S. 11 (1930), this Court held that where a contract to sell property did not create an *unconditional liability* on the part of the vendee for the purchase price within the taxable year, the taxpayer "was not entitled" to return the proceeds of the sale as taxable income within that year, even though the taxpayer reported its income on the accrual basis.

The essential difference between an item of property and an item of income was clearly recognized in *Estate of Burnett v. Commissioner,* 2 T.C. 897 (1943), which

was acquiesced in by the Commissioner of Internal Revenue, 1944 Cum. Bull. 4. The Court held in favor of the taxpayer as against the Commissioner's contention that the fair market value of livestock and feed raised by the decedent not disposed of prior to his death should be included in computing the decedent's net income for the final period preceding his death. The Court emphasized that the "property had not been sold or exchanged by decedent at the time of his death" and that "No one was indebted to him for its fair market value". This principle was again approved by the Internal Revenue Service in Rev. Bull. 58-436, 1958-2 Cum. Bull. 366, 367, holding that the principles of *Burnett* are applicable under Section 691 even though *Burnett* was decided prior to the enactment of such section and prior also to the time of its counterpart, Section 126 of the Internal Revenue Code of 1939. In this same Revenue Ruling the Internal Revenue Service stated quite clearly that "income in respect of a decedent concerns items of income and not items of property." The Fifth Circuit failed completely to recognize this critical distinction.

D. Dinkler Contract Subject to Unperformed Conditions Precedent at Decedent's Death.

At the date of Mr. Dinkler's death he had no cause of action, either for the purchase price or for damages for the gain eventually realized or for specific performance of the contract. If this were a case in which equitable conversion had occurred the decision of the Fifth Circuit might be correct. Short of such a situation no right to the proceeds of the sale or income existed. No one, at the date of his death, could have predicted with any assurance that a sale would ever take place or a right to the proceeds would ever arise which would mature into an "item of gross income" under Section 691 or any other provision of the Internal Revenue Code. What is the legal nature of

Mr. Dinkler's right to income, if any, on the date of his death? The decision of the Fifth Circuit offers no answer to this all-important question of law.

It is highly speculative whether the contract would have been performed had Mr. Dinkler lived. With the Purchaser being short at Mr. Dinkler's death of $2,350,000 required to close, it is doubtful if Mr. Dinkler would have accepted an amendment to the contract resulting in his receiving $500,000 more in notes instead of such $500,000 in cash, and it is doubtful if the Trust Company would have loaned $1,500,000 since it then would not have been necessary for it to act to avoid having the responsibility of operating "a very big hotel chain" (R. Vol. I, 105). Also, it is not known whether secondary sources would have made the loan or whether Associated would have sought such a loan at the exorbitant cost of 15% interest (R. Vol. I, 123).

If, indeed, the statute has reference to the date of death of the decedent (as the Fifth Circuit held and we think correctly so), then the application of the test in the Fifth Circuit's decision is taxation by conjecture confirmed by hindsight, for on the date of his death, Mr. Dinkler had nothing more than a hope of performance of all the conditions including eventual payment of the purchase-price by a new corporation with a meager capital of $45,000 already, as of the date of death, resorting to methods bordering on those of desperation to raise the funds required. As a matter of law, the decedent had *no* right to income at the date of his death, just as "A" in Example (5)(1), Regulations, 1.691 (a)-2(b) had no right to income prior to his death (Appendix B p. B4).

II. The Decision of the Fifth Circuit Will Produce Uncertainty and Confusion in the Administration of Estates and Decides an Important Question of Income Tax Law which Has Not Been, but Should Be, Settled by this Court.

The decision of the Fifth Circuit extends the statutory language, "the amount of all items of gross income," to include what has never in the history of the income tax law been considered income of any kind, namely, unrealized appreciation in the value of property. Its impact upon the administration of estates and the taxation of income is enormous and far-reaching. Thousands of simple, unperformed, conditional contracts to sell property will, where the conditions precedent to closing eventually are performed after the death of the signer of the contracts, produce taxable income in situations not heretofore taxable. The purpose of Section 691 is to tax to the recipients income to which the decedent was *entitled* but had not collected on the date of his death. It was never intended to *create* taxable income by converting into gross income unrealized appreciation in property owned by a decedent, and not sold or otherwise finally disposed of, as of the date of death.

If the result reached by the Fifth Circuit is to become law, Section 691 should be amended by Congress rather than by judicial decision running counter to almost half a century of cases carefully construing the meaning of "income" for the purpose of taxation.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

FRANCIS SHACKELFORD

JAMES E. THOMAS

JOHN W. GILLON

Attorneys for Petitioners

_____, 1968

CERTIFICATE OF SERVICE

I hereby certify that I have this day mailed a copy of the attached petition with appendices to the Honorable Erwin N. Griswold, Solicitor General of the United States, Department of Justice, Washington, D. C. 20530, with sufficient postage attached.

This _____ day of _____, 1968.

Attorney for Petitioner

APPENDIX A

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 24577

TRUST COMPANY OF GEORGIA, Executor Under the Will of Carling Dinkler, Sr., ET AL,

Appellant,

versus

AUBREY C. ROSS, District Director of Internal Revenue,

Appellee.

APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF GEORGIA.

(December 20, 1967.)

Before TUTTLE and BELL, Circuit Judges and HOOPER, Senior District Judge.

PER CURIAM: The issue presented on this appeal is whether the trial court erred in holding that the gain realized on the sale of corporate stock was taxable as "in-

come in respect of a decedent" within the meaning of § 691 of the Internal Revenue Code of 1954.[1]

The carefully considered and comprehensive opinion of the trial court is reported. *Trust Company of Georgia v. Ross,* N.D. Ga., 1966, 262 F.Supp. 900. It contains a sufficient factual presentation and we would adopt it in its entirety but for the test employed. The test, ". . . whether the post death payments are in fact due to the services performed by or the economic activities of the decedent", *Id.* at *908,* is open-ended and somewhat inadequate as a precedent when considered in the scope of the statute. We do conclude, however, that the court reached the correct result and thus affirm.

The District Court was not charting a new course in employing this test. Several courts have used the same test but the *ratio decidendi* in each instance, of course, depended on the subsisting facts. For example, several of the cases related to bonus or partnership payments made after death pursuant to rights created by the decedent during his lifetime. See, e.g., *Riegelman's Estate*

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[1] 26 USCA §691, in pertinent part:

(a) *Inclusion in Gross Income.*—

(1) *General Rule.*—The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period (including the amount of all items of gross income in respect of a prior decedent, if the right to receive such amount was acquired by reason of the death of the prior decedent or by bequest, devise, or inheritance from the prior decedent) shall be included in the gross income, for the taxable year when received, of:

(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;

(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

v. Commissioner of Internal Revenue, 2 Cir., 1957, 253 F.2d 315; *Bernard v. United States*, S.D. N.Y., 1963, 215 F.Supp. 256; *United States v. Ellis*, S.D. N.Y., 1957, 154 F.Supp. 32.[2] In another case the payment was made pursuant to a contract to receive payment for grapes which were delivered into a wine pool during the lifetime of the decedent. *Commissioner of Internal Revenue v. Linde*, 9 Cir., 1954, 213 F.2d 1. In still another case the payment was for crop rents due under contracts entered into by the decedent in his lifetime. *Davison's Estate v. United States*, Ct. Cl., 1961, 292 F.2d 937.

Although it is pertinent to inquire whether the income received after death was attributable to activities and economic efforts of the decedent in his lifetime, these activities and efforts must give rise to a right to that income. And the right is to be distinguished from the activity which creates the right. Absent such a right, no matter how great the activities or efforts, there would be no taxable income under § 691. For a compilation of the various factual situations involving § 691 see the cases in 2 Mertens § 12.102c, pp. 302-310.

The tortuous language of the statute is of little help in divining the proper test, but the regulation does help. The regulation, 26 CFR 1.691(a)-1 entitled "Income in respect of a decedent" provides in pertinent part:

> "(b) *General definition.* In general, the term 'income in respect of a decedent' refers to those amounts to which a decedent was *entitled* as gross income but which were not properly includible in computing his taxable income for the taxable year ending with the date of his death or for a previous

[2] In *O'Daniel's Estate v. Commissioner of Internal Revenue*, 2 Cir., 1949, 173 F.2d 966, a case involving a bonus payment, Judge Augustus Hand noted that the right acquired during decedent's lifetime need not be a legally enforceable one, "but merely any *right* derived through his services rendered while living." (emphasis added.) Id. at 968.

taxable year under the method of accounting employed by the decedent . . . ." (Emphasis added)

It is implicit in the statute and in the definition that this condition or limitation has reference to the date of death of the decedent. That is, income is to be included if decedent was entitled to the income at the date of his death. The entitlement test is in accord with the right to income test discussed, *supra,* and is more precise than the causal connection test used by the District Court.[3]

There remains the problem of applying the right to income test to the case before us. Ordinarily, in a non-jury trial where an improper test has been applied, the accepted procedure is to remand to the trial court with the direction that the matter be reconsidered in the light of the proper test. *Cf. Malat v. Riddell,* 1966, 383 U.S. 569, 572, 86 S.Ct. 1030, 16 L.Ed.2d 102. Here, we conclude that the decision of the trial court, in effect, is based on the right to income test; it simply was not articulated as such.

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[3] 26 CFR 1.691 (a)-2, example (5) (1) states:

"A owned and operated an apple orchard. During his lifetime, A sold and delivered 1,000 bushels of apples to X, a canning factory, but did not receive payment before his death. A also entered into negotiations to sell 3,000 bushels of apples to Y, a canning factory, but did not complete the sale before his death. After A's death, the executor received payment from X. He also completed the sale to Y and transferred to Y 1,200 bushels of apples on hand at A's death and harvested and transferred an additional 1,800 bushels. The gain from the sale of apples by A to X constitutes income in respect of a decedent when received. On the other hand, the gain from the sale of apples by the executor to Y does not."

Note that the sale to Y was not complete. No contract had been effected. Yet negotiations had commenced and had been carried on by A, the decedent, prior to his death. The sale went through after A's death. The regulations state that this is *not* income in respect of a decedent. However a contrary result could easily be reached under the broad test used by the District Court since it could well be found that the sale was a result of the negotiations by A, or a result of the "services performed by or the economic activities of the decedent" during his lifetime. What is lacking in the example, of course, is any *right* on A's part to receive the income prior to his death.

Mr. Dinkler entered into a binding contract prior to his death. That contract required the conveyance of the property from whence the income in litigation was derived. The contract created a right to these proceeds in Mr. Dinkler at the time the contract was executed. The contract inured to and was binding upon his executor. It is true that some aspects of the transaction which the contract contemplated had to be performed by his executor but these were not of such scope as would negate the right which was his under the contract.

The contract contained a liquidated damages clause but this did not transform the contract into a mere option. See 1A Corbin on Contracts § 274, pp 608-609 (1963). The clause became effective only in the event of a default on the part of the purchaser. It did not constitute an agreement simply to permit termination of the contract in the event the seller did not wish to go forward.

Therefore, applying the entitlement or right to income test, it would appear that the disputed amount is income in respect of a decedent.

AFFIRMED.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Georgia, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed;

It is further ordered and adjudged that the appellants, Trust Company of Georgia, Executor under the Will of Carling Dinkler, Sr., and others, be condemned, in solido,

to pay the costs of this cause in this Court for which execution may be issued out of the said District Court.

PETITION FOR REHEARING EN BANC

March 7, 1968

PER CURIAM:

The Petition for Rehearing is DENIED and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, Rule 25(a), subpar. (b), the Petition for Rehearing En Banc is

DENIED.

United States District Court

NORTHERN DISTRICT OF GEORGIA

ATLANTA DIVISION

TRUST COMPANY OF GEORGIA Executor under the Will of Carling Dinkler, Sr., *Plaintiff* *vs.* AUBREY C. ROSS, District Director of Internal Revenue, *Defendant*	CIVIL ACTION No. 9609
CARLING L. DINKLER, JR. and CORNELIA V. DINKLER, *Plaintiffs* *vs.* AUBREY C. ROSS, District Director of Internal Revenue, *Defendant*	CIVIL ACTION No. 9610
TRUST COMPANY OF GEORGIA, Executor under the Will of C. L. Dinkler, Sr. and MRS. JOEL W. DINKLER, surviving wife, *Plaintiffs* *vs.* AUBREY C. ROSS, District Director of Internal Revenue, *Defendant*	CIVIL ACTION No. 9611

In these actions, which have been consolidated for trial, the plaintiffs seek the recovery of income taxes and interest paid for the year 1961 in the total amount of $1,007,376.09. Jurisdiction of the Court is invoked under Title 28, U.S.C., Section 1346(a)(1).

All of the basic facts were stipulated by the parties.

The actions were tried before this Court without a jury. After hearing the testimony; examining the exhibits, briefs and pleadings of the parties, the case is now properly before the Court for determination.

The Dinkler Hotel chain was founded in the early 1920's by Carling Dinkler, Sr., and his father, and in 1960 consisted of the Dinkler-Tutwiler Corporation, Dinkler-Forsyth Corporation, Hotel Tutwiler Operating Company, Inc., Andrew Jackson Hotel Operating Company, Hotel Dinkler Plaza Operating Company, Belvedere Corporation and Dinkler Hotels Company, Inc. Carling Dinkler, Sr., individually, owned all of the stock of Dinkler Tutwiler Corporation and, together with his wife and son, owned approximately 83 percent of the stock of Dinkler Hotels Company, Inc. (the rest of which stock was publicly held). Carling Dinkler, Sr., as trustee, owned all of the stock of Dinkler-Forsyth Corporation. Dinkler Hotels Company, Inc., owned the stock of Hotel Tutwiler Operating Company, Inc., Hotel Dinkler Plaza Operating Company, and Andrew Jackson Hotel Operating Company. The stock of Belvedere Corporation was owned by Hotel Dinkler Plaza Operating Company. Dinkler Hotels were operated in Atlanta, Georgia, Birmingham and Montgomery, Alabama, and Nashville, Tennessee.

In the spring of 1960, a broker, on behalf of Robert K. Lifton and his associates, made inquiries of Carling Dinkler, Jr., relative to the possible purchase of either the stock or assets of the companies which made up the Dinkler Hotel chain.

A conference was scheduled for and held on or about July 20, 1960, wherein Carling Dinkler, Jr., Carling Dinkler, Sr., Frank E. Spain of Birmingham, Alabama, Vice-President and General Counsel of Dinkler Hotels Company, Inc., and others represented the Dinklers, and Robert K. Lifton, Ira J. Hechler and Howard Weingrow represented the prospective buyers. This conference resulted in a verbal understanding to sell and to buy by the respective parties with a written agreement to follow.

On August 4, 1960, a written agreement was executed by Carling Dinkler, Sr., individually, Carling Dinkler, Sr., as Trustee for Carling Dinkler, Jr., Carling Dinkler, Jr., individually, and Dinkler Hotels Company, Inc. "Dinklers"), with Associated Hotels Corporation, a newly formed corporation of which Robert K. Lifton, Ira J. Hechler and Howard Weingrow were the principal stockholders ("Associated"). By this agreement, the Dinklers agreed to sell and the buyers agreed to buy either the stock or assets of all the corporations making up the Dinkler Hotel chain.[1]

Contemporaneously with the signing of the aforesaid agreement, a management contract was entered into between Associated and Carling Dinkler, Sr., and Carling Dinkler, Jr., dated August 4, 1960.

The total purchase price for all of the assets and properties was stated in Paragraph 2 of said agreement as $10,946,363.00, subject to certain adjustments based upon an audit of June 30, 1960, Balance Sheets by Harris, Kerr, Forster & Company, and was to be paid in cash and by delivery of demand promissory notes, it being contemplated that the corporations involved would be forthwith liquidated so that the funds with which to pay the de-

[1] Under the contract, Associated was to purchase the stock of Dinkler-Tutwiler Corporation and Dinkler-Forsyth Corporation, as well as the assets of Dinkler Hotels Company, Inc. These actions only involve the payment made for the stock of Dinkler-Tutwiler Corporation, individually owned by Carling Dinkler, Sr.

mand notes would be available from cash on hand in said corporations. The price at which the Dinkler-Tutwiler Corporation stock was to be sold, all of which stock was owned by Carling Dinkler, Sr., was specified in said agreement to be $3,381,933.30. Said price as stated was subject to certain adjustments provided for in said agreement, and after making such adjustments, the amount finally received by the Estate of Carling Dinkler, Sr., on February 23, 1961, for such stock was $3,539,948.00.

As provided for in Section 2 of the agreement, Associated deposited $300,000.00 and executed copies of the agreement with Frank E. Spain, as Escrow Agent, contemporaneously with the execution of said agreement. By letter dated August 31, 1960, to Frank E. Spain from Associated, the provisions of the escrow agreement were waived and the $300,000.00 was delivered to the Dinklers, and the executed copies of the agreement of August 4, 1960, were delivered to the respective parties to such agreement.

Under Section 3 of the agreement of August 4, 1960, all of the stock subject to the agreement, including the stock certificates evidencing the Dinkler-Tutwiler Corporation stock, were placed in escrow with Frank Spain, registered in the name of Carling Dinkler, Sr., with separate assignments executed by the registered holder in blank. This stock remained in the possession of Escrow Agent Mr. Spain until delivered to Associated on February 23, 1961. Section 3 of the said agreement provided in part:

> "In the event . . . that the Buyer shall default in the performance of any of its obligations under this Agreement, then the Escrow Agent shall redeliver the stock certificates and stock powers to the respective Sellers from whom they were received, and the Sellers shall retain all payments of the purchase price theretofore made as liquidated damages."

Section 17 of the August 4, 1960, agreement provided:

> "*Total Loss of Dinkler Plaza Hotel:* In the event that prior to the closing there is a total loss of the Dinkler Plaza Hotel by casualty (including fire), whether or not compensable by insurance or condemnation, then any party on notice to the other parties may elect to cancel this Agreement within ten days of such loss in which event all obligations of the parties (except with respect to the return of amounts paid by the Buyer) shall cease and terminate."

The audit report of Harris, Kerr, Forster & Company called for by Section 2 of the August 4, 1960, agreement was received on or about November 25, 1960.

The ruling from the Treasury Department of the United States called for by Section 15 of the August 4, 1960, agreement was issued on December 2, 1960. This ruling held that Section 337 of the Internal Revenue Code of 1954 would apply to the sale of the assets of Dinkler Hotels Company, Inc., and no gain or loss would be recognized in the hands of said company if a plan of complete liquidation were adopted on the same date as the sale of such assets under the August 4, 1960, agreement.

Under the August 4, 1960, agreement, the closing was to be completed on January 3, 1961. On December 16, 1960, Mr. Spain wrote to E. M. Turlington, Sr., Vice-President of Dinkler Hotels Company, Inc., who was assisting Mr. Spain in readying all matters to complete the sale, as follows: "So for the moment I believe we have done everything needful to be done before Jan. 3". By December 16th, the legal representatives of the Dinklers and Associated were preparing the closing agenda.

By letter dated December 20, 1960, from Associated to Dinkler Hotels Company, Inc., Messrs. Carling Dinkler, Sr., and Carling Dinkler, Jr., accompanied by checks in the aggregate amount of $200,000.00, post-dated to Janu-

ary 3, 1961, the right of Associated to close under the August 4, 1960, agreement was extended to March 1, 1961. This postponement was provided for in the August 4th contract. Associated Hotels Corporation continued the closing date in order that Transcontinental Investing Company could obtain the permission of the Securities and Exchange Commission to make a public exchange offer, whereby Transcontinental would acquire the Dinkler properties to be acquired by Associated Hotels along with other similar properties. The initial prospectus of Transcontinental with regard to this matter was filed with the Securities and Exchange Commission in October, 1960. The Securities and Exchange Commission had not granted its approval to Transcontinental Investing Corporation by December 16, 1960, and it was unlikely that the approval would be obtained by the original closing date of January 3, 1961. The Securities and Exchange Commission granted its approval on this matter on January 27, 1961.

Carling Dinkler, Sr., died on January 30, 1961. His will was probated in the Court of Ordinary of DeKalb County, Georgia, on February 6, 1961, and the Trust Company of Georgia duly qualified as executor of the will.

Prior to January 30, 1961, Associated Hotels Corporation had indicated to Carling Dinkler, Sr., that it did not wish to purchase any interest in the Jefferson Davis Corporation, whose stock was owned by the Dinkler-Tutwiler Corporation and others. Prior to his death, Carling Dinkler, Sr., representing the Dinklers, agreed with Associated Hotels that the Dinkler-Tutwiler Corporation would sell its stock in the Jefferson Davis Corporation, thus eliminating that stock from the August 4 contract. Subsequently, by amendment dated February 23, 1961, signed by the Estate of Carling Dinkler, Sr., and Associated, the foregoing agreement which had been reached

before the death of Carling Dinkler, Sr., was memorialized.

On February 6, 1961, Mr. Spain wrote C. H. Hyams, III, a director of Dinkler Hotels Operating Company, Inc., wherein he stated as folows:

> "Fortunately all of our plans for the closing of the sale with Associated Hotels Corporation had been developed to the point where Carling's death will not affect [sic] the result. While in Atlanta I cleared with the New York attorneys on the further procedures. The recessed stockholders meeting of January 3 was to have been held on the day of the funeral. No one from outside came and the meeting was further recessed until February 22nd. You have received notice."

On or about February 1, 1961, officers of Associated advised Mr. Spain, counsel for the Dinklers, that Associated lacked $2,350,000.00 of having sufficient funds to enable Associated to close under the August 4, 1960, agreement, and asked whether the Estate of Carling Dinkler, Sr., would lend such amount to Associated. Counsel for the Dinklers, Mr. Spain, replied that he would not so advise the Executor because he did not consider it a proper loan for an executor to make. He stated that he would, and he did, introduce the officers of Associated to officers of the Commercial Department of Trust Company of Georgia. Negotiations followed in which counsel for the Dinklers did not participate. The Commercial Department of Trust Company of Georgia did lend to Robert K. Lifton, Ira J. Hechler and Howard Weingrow, the principal stockholders and officers of Associated, $2,000,000.00 on condition that the borrowers concurrently therewith loaned Associated $2,350,000.00, taking Associated's note therefor, which they then assigned to Trust Company of Georgia as security for its $2,000,000.00 loan to the stockholders

and officers of Associated. The $2,000,000.00 loan was beyond the lending limits of Trust Company of Georgia, and in order to enable such loan to be made, Trust Company of Georgia, as Executor under the Will of Carling Dinkler, Sr., agreed to and did accept a $500,000.00 participation in the loan. The remainder of the purchase money was obtained from other sources.

The negotiations for the foregoing loan were conducted by Messrs. Lifton, Hechler and Weingrow with the Commercial Department of the Trust Company of Georgia, and not with the Trust Department of the latter, which was acting as Executor of the Estate of Carling Dinkler, Sr.

Mr. Augustus H. Sterne, presently President of the Trust Company of Georgia, was the principal bank officer with the Commercial Department negotiating the loan. The Dinklers had transacted its banking business with the Trust Company of Georgia for many years and the bank had found this relationsihp profitable. The bank was interested in keeping these accounts when Associated Hotels completed its purchase of the Dinkler properties. In late 1960, Mr. Sterne traveled to New York and spoke with Messrs. Lifton, Hechler and Weingrow to encourage them to continue doing business with Trust Company of Georgia after the sale was consummated. This desire on the part of Trust Company of Georgia to have Associated continue the business relationship it had enjoyed over the years with Dinklers, was one of the compelling reasons why the bank agreed to arrange credit of $2,000,000.00 for Messrs. Lifton, Hechler and Weingrow. Eventually, the Commercial Department of the bank obtained a participation in the $2,000,000.00 loan granted to the extent said loan exceeded its legal loan limits. The bank would have loaned the entire amount itself without any participation, but for the legal loan limit.

Thereafter, on February 23, 1961, the August 4, 1960, agreement was amended by (1) allowing Dinkler-Tutwiler Corporation to sell the stock in Jefferson Davis Corporation, which the latter owned, with the price to be paid for the Dinkler-Tutwiler stock to be correspondingly increased, (2) Associated waiving any claim it might have on life insurance policies held by Dinkler Hotels, Inc., and Dinkler-Tutwiler Corporation on Carling Dinkler, Sr., in excess of a certain figure with a resulting price adjustment, and (3) providing the purchase price would be paid in checks not exceeding $6,215,000.00, and the balance in demand notes. Item 2 of this amendment had already been agreed to by the parties by supplemental agreement dated August 4, 1960.

On the same date, the agreement as amended was consummated and the adjusted price of $3,539,948.00, representing the price of Dinkler-Tutwiler Corporation stock owned by Carling Dinkler, Sr., was paid to the Estate of Carling Dinkler, Sr.

In the fiduciary income tax return for the fiscal period ended June 30, 1961, the Executor reflected a basis for the Dinkler-Tutwiler Corporation stock of $3,539,948.00, which was the fair market value of the stock on January 30, 1961, the date of the death of Carling Dinkler, Sr. No gain was reported by the Executor on the fiduciary income tax return for the fiscal period nor by the beneficiaries of the estate (Mrs. Joel W. Dinkler and Carling L. Dinkler, Jr.) in their respective income tax returns for their taxable years ended December 31, 1961.

The Commissioner of Internal Revenue held that the proceeds from the sale of the Dinkler-Tutwiler stock constituted income in respect of a decedent under Section 691 of the Internal Revenue Code of 1954; and further held that a long term capital gain in the amount of $3,454,863.56 was realized on the sale.

These deficiencies were paid in full by the respective parties and, after each party filed a claim for refund which were rejected, these actions, which have been consolidated for trial, were filed.

The question for determination by this Court is whether, under the facts and circumstances, any of the proceeds received by the Estate of Carling Dinkler, Sr., from the disposition of stock constitute income with respect to a decedent and thus taxable as determined by the Commissioner. The applicable provisions of the statutes and Treasury Regulations are set forth in the following footnote:[2]

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[2] Internal Revenue Code of 1954:

SEC. 691. RECIPIENTS OF INCOME IN RESPECT OF DECEDENTS.

(a) *Inclusion in Gross Income.*—

(1) *General rule.*—The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period (including the right to receive such amount was acquired by reason of the death of the prior decedent or by bequests, devise, or inheritance from the prior decedent) shall be included in the gross income, for the taxable year when received, of:

(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;

(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the the amount is received after a distribution by the decedent's estate of such right.

* * * * * * *

(3) *Character of income determined by reference to decedent.*—The right, described in paragraph (1), to receive an amount shall be treated, in the hands of the estate of the decedent or any person who acquired such right by reason of the death of the decedent, or by bequest, devise, or inheritance from the decedent, as if it had been acquired by the estate or such person in the transaction in which the right to receive the income was originally derived and the amount

includible in gross income under paragraph (1) or (2) shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount.

* * * * * * *

(26 U.S.C. 1964 ed., Sec. 691.)

Treasury Regulations on Income Tax (1954) Code):

SEC. 1.691 (a)-1. *Income in respect of a decedent.*

* * * * * * *

(b) *General definition.*—In general, the term "income in respect of a decedent" refers to those amounts to which a decedent was entitled as gross income but which were not properly includible in computing his taxable income for the taxable year ending with the date of his death or for a previous taxable year under the method of accounting employed by the decedent. See the regulations under section 451. Thus, the term includes—

(1) All accrued income of a decedent who reported his income by use of the cash receipts and disbursements method;

(2) Income accrued solely by reason of the decedent's death in case of a decedent who reports his income by use of an accrual method of accounting; and

(3) Income to which the decedent had a contingent claim at the time of his death.

(26 C.F.R., Sec. 1.691(a) 1.)

* * * * * * *

Sec. 1.691 (a)-2. *Inclusion in gross income by recipients*

(a) Under section 691 (a) (1), income in respect of a decedent shall be included in the gross income, for the taxable year when received, of—

(1) The estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent

(2) The person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

(3) The person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

These amounts are included in the income of the estate or of such person when received by them whether or not they report income by use of the cash receipts and disbursements method.

(26 C.F.R., Sec. 1.691 (a)-2.)

* * * * * * *

Sec. 1.691 (a)-3. *Character of gross income.*

(a) The right to receive an amount of income in respect of a decedent shall be treated in the hands of the estate, or by the person entitled to receive such amount by bequest, devise, or inheritance from the decedent or by reason of his death, as if it had been

Were the proceeds from the sale of Dinkler-Tutwiler Corporation stock income to Mr. Dinkler, Sr., and taxable as such? The plaintiffs contend that no sale had occurred prior to Mr. Dinkler, Sr.'s, death, and thus the proceeds were not taxable. The Government asserts that the transaction was completed by Mr. Dinkler, Sr., prior to his death, and that all that remained was the closing and payment, and that the income was entirely generated by Mr. Dinkler, Sr.'s, activities and constitutes income in respect of the decedent, Mr. Dinkler, Sr.

Section 691 of the Internal Revenue Code of 1954 provides for taxation of income in respect of decedents. Section 691(a)(1) provides, as a general rule, that the amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period shall be included in the gross income, for the taxable year when received, of (A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the deceednt; (B) the person who, by reason of the death of the decedent, acquires

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acquired in the transaction by which the decedent (or a prior decedent) acquired such right, and shall be considered as having the same character it would have had if the decedent (or a prior decedent) had lived and received such amount. The provisions of section 1014 (a), relating to the basis of property acquired from a decedent, do not apply to these amounts in the hands of the estate and such persons. See section 1014 (c).

(b) The application of paragraph (a) of this section may be illustrated by the following:

(1) If the income would have been capital gain to the decedent, if he had lived and had received it, from the sale of property held for more than 6 months, the income when received, shall be treated in the hands of the estate or of such person as capital gain from the sale of the property, held for more than 6 months, in the same manner as if such person had held the property for the period the decedent held it, and had made the sale.

* * * * * * *

(26 C.F.R., Sec. 1.691 (a)-3.)

the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or (C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

Section 691(a)(3) relates to the character of income, and it provides that the right, described in paragraph (1), to receive an amount shall be treated, in the hands of the estate of the decedent or any person who acquired such right by reason of the death of the decedent, or by bequest, devise, or inheritance from the decedent, as if it had been acquired by the estate or such person in the transaction by which the decedent acquired such right; and the amount includible in gross income shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount.

Section 691(c) provides that a person who includes an amount in gross income under subsection (a) shall be allowed a deduction with respect to the estate tax attributable to the item, and it further provides the method of computing the deduction. There is no question as to this in the instant cases, and it is unnecessary to consider it here.

The applicable Regulations (Treasury Regulations, Sec. 1.691 (a)(3) contain the following provisions:

> (a) The right to receive an amount of income in respect of a decedent shall be treated in the hands of the estate, or by the person entitled to receive such amount by bequest, devise, or inheritance from the decedent or by reason of his death, as if it had been acquired in the transaction by which the decedent

(or a prior decedent) acquired such right, and shall be considered as having the same character it would have had if the decedent (or a prior decedent) had lived and received such amount. * * * *

(b) * * *

(1) If the income would have been capital gain to the decedent, if he had lived and had received it, from the sale of property held for more than 6 months, the income when received, shall be treated in the hands of the estate or of such person as capital gain from the sale of the property, held for more than 6 months, in the same manner as if such person had held the property for the period the decedent held it, and had made the sale.

The legislative history of Section 691 is outlined by Chief Judge Jones in the Court of Claims opinion in the case of *Davison's Estate* v. *United States*, 292 F.2d 937 (Ct. Cl., 1961). We may summarize this history as follows:

Section 42 of the Revenue Act of 1934, c. 277, 48 Stat. 680, required all income accrued up to the date of death, not otherwise properly includible for such period or a prior period, to be included in the income tax return of a decedent for the period in which fell the date of his death. The provision was enacted because the courts had held under prior law that income accrued before death but received by the estate was not income to the estate but a part of the corpus. Hence, prior to this provision of the Revenue Act of 1934 neither the estate nor the decedent ever paid income tax on such amounts. Similarly, in the case of capital transactions as here, no income would be payable to the estate even when the actual transfer took place after death. This resulted from the fact that the estate's basis in such assets would be their

fair market value at the date of death, and hence there would be no capital gain since such value would equal the sale price.

This provision of the Revenue Act of 1934 required the inclusion of the value of services rendered, whether based on agreed compensation or on *quantum meruit*, in decedent's final return as accrued income. *Helvering* v. *Enright*, 312 U.S. 636. In some instances, such treatment resulted in hardship as, quite frequently, amounts which would have been received over a number of years were returnable in the year of death, thus carrying the income into higher brackets due to the bunching of such income.

To alleviate such hardship, Section 126 of the Code was added to the 1939 Code by Section 134 of the Revenue Act of 1942, c. 619, 56 Stat. 798, to provide that income accruing to a decedent because of his death was not includible in his final return, but was to be treated as income and reported as income by the one receiving the right to such income. Such treatment was for the express purpose of alleviating a hardship and, at the same time, preventing certain income from escaping taxation, as above described. Eventually, Section 126 was reenacted as Section 691 of the Internal Revenue Code of 1954, without material change.

In the cases under consideration, the estate of Carling Dinkler, Sr., received $3,539,948.00 when the transaction provided for in the August 4 agreement was formally closed on February 23, 1961. Certain distributions had been made to Mrs. Joel W. Dinkler and Carling Dinkler, Jr. Thus, the application of Section 691 to the transaction involved rendered it necessary to assess deficiency taxes against each of the three parties to these actions.

Although Congress failed to specifically define precisely what income in respect of a decedent is, this Court

feels that it is clear that the intent of Congress was, as stated in *Helvering* v. *Enright,* supra, "to cover into income the assets of decedents, earned during their life and unreported as income". This section covers income from all sources, including capital gains such as in the instant case. The purpose of Section 691 and its predecessor sections was to reduce the importance of death in the actual collection of the revenue.

Thus, there is no doubt that the plaintiffs acquired the right to receive the amounts from the sale of the Dinkler-Tutwiler stock from Carling Dinkler, Sr., and, under Section 691(a)(3), that right is to have the same character in the hands of the plaintiffs which it would have had in the hands of Carling Dinkler, Sr. The cases have held consistently that the criterion of taxability of income as income in respect of a decedent is whether the post-death payments are in fact due to the services performed by or economic activities of the decedent. *Grill* v. *United States,* 303 F.2d 922; *Davison's Estate* v. *United States,* 292 F.2d 937; *United States* v. *Ellis,* 264 F.2d 325; *Riegelman's Estate* v. *Commissioner of Internal Revenue,* 253 F.2d 315; *Commissioner of Internal Revenue* v. *Linde,* 213 F.2d 1, cert. den. 348 U.S. 871; *Bernard* v. *United States,* 215 F.Supp. 256. Payments are taxable under Section 691 even though realized after the decedent's death when such payments arise from contracts, arrangements, or deals made by the decedent and would have been income to the decedent. *Levin* v. *U. S.,* 254 F. Supp. 640 (1966).

In the cases at hand, both the plaintiffs and the decedent strongly rely upon the case of *Commissioner* v. *Linde,* supra. In the *Linde* case, the decedent had negotiated for the disposition of his grapes and no substantial activity was required of his estate in order to produce the income, and the Court found in the *Linde* case that

the payments in issue were income in respect of a decedent. There the decedent had delivered grapes to various cooperatives of which he was a member, and the latter commingled all members' grapes in a "wine pool". The grapes in such pool were crushed, processed into wine, the wine sold, expenses deducted from the wine proceeds, and each member's share of the proceeds thereafter was distributed to the member by the cooperatives. The Court held that the proceeds from the "wine pool" received after decedent's death by his beneficiary where the grapes had been delivered befor death constituted income in respect of a decedent. In so holding, the Court expressly noted that it was not necessary to establish a sale by the decedent during his lifetime.

In ruling that Section 126, the predecessor section of Section 691, applied, the Court in *Linde* stated, referring to the decision in *O'Daniel's Estate* v. *Commissioner*, 173 F.2d 966:

> "We think that the text of section 126 as well as the history of the legislation relating to the income of a decedent demonstrate the soundness of the *O'Daniel* decision and that the principles there expressed must be applied in the instant case. If the decedent had lived until the day when these crop pool proceeds were paid to him the payments so received would have been ordinary income. Sec. 126 itself contains strong evidence of congressional intent to see to it that the tax upon income which would have been derived had the decedent lived should not be lost to the treasury in consequence of his death. This subparagraph (3) of section 126(a) provides that 'the amount includible in gross income under paragraph (1) * * * shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived

and received such amount'. The payments which the taxpayer received in 1945 were realized under and in consequence of contracts and deals made by the decedent in his lifetime. No act or thing taken or performed by the taxpayer operated to procure or to give rise to this payment. Such payments had their source exclusively in the decedent's contract and arrangement with the cooperative associations. And since in his hands had he lived and received these amounts they would have had the character of ordinary income, the quoted provision of subdivision (3) would make it appear that they have the same character, that is, ordinary income, in the hands of this taxpayer who acquired the right to receive that amount by bequest from the decedent within the meaning of subdivision (C) of subparagraph (1) of section 126 (a)."

In the cases at hand, the payment received by the estate of Carling Dinkler, Sr., on February 23, 1961, the date of the closing of the August 4, 1960, agreement, was realized as a consequence of negotiations and agreement made by Mr. Carling Dinkler, Sr., during his lifetime. It was his economic activity leading up to and including the signing of the August 4 agreement which produced the income now in dispute. There were no acts of any consequence taken or performed by the estate of Mr. Dinkler, Sr., which operated to procure or give rise to the payments involved. Such payments were the direct result of the efforts of Carling Dinkler, Sr., and nothing of substance remained to be performed after his death except the formal closing.

The evidence submitted reveals that the Dinklers had, prior to Mr. Dinkler, Sr.'s, death, accomplished all the matters needed to be performed by them to effect the closing. On the date of his death, Carling Dinkler, Sr.,

had only to await the date of the closing to receive the sums due under the contract of sale which he had negotiated prior to his death. The stock had been placed in escrow to await payment of the purchase price; Mr. Dinkler, Sr., was contractually bound to sell it to these particular purchasers and was not free to sell it to any other persons. The moneys eventually received by his estate at the closing were not due to any economic activity of the estate. The estate's right to the purchase price was due solely to the death of the decedent. The matters in which the estate participated and by which the closing was consummated were merely perfunctory and of no material significance.

The plaintiffs contend that (1) the August 4 agreement was an option in favor of Associated, the purchasers; (2) by the date of death, Carling Dinkler, Sr., had not made a disposition by sale or other arrangement of the stock in issue; (3) all of the conditions of the agreement had not been met by the date of Dinkler's death and performance of the management contract was rendered impossible by his death; (4) nothing was owed Carling Dinkler, Sr., at the time of his death; and (5) the sale of the stock was made pursuant to an amended agreement resulting from the efforts of the estate.

Initially, the August 4 agreement was not an option to purchase in favor of Associated. Ordinarily, where someone grants another an option to purchase, he retains control over the subject matter of the option until such time as the option is exercised and the sale is completed. In this case, the subject of the contract, namely, the stock, was placed beyond the dominion and control of Dinkler with Frank Spain, the Escrow Agent. This agreement was similar to the every-day type of agreement to sell real estate whereby the seller's only remedy, if the purchaser defaults, is to obtain the difference between the

fair market value of the property at the time of the default and the contract price, for the seller is not free to dispose of the property to a third party until such default has occurred. Here, Carling Dinkler, Sr., would have had a similar remedy, except that, under the agreement, the parties agreed as to the amount of liquidated damages in advance, namely, the forfeiture of the earnest money.

The plaintiffs' second contention is that no sale or other disposition had occurred by the date of Mr. Dinkler's death. It is true that no sale of the stock had occurred; however, a significant disposition of the stock had been accomplished because months before the date of Mr. Dinkler's death, in performance of his contract, he had placed the stock in escrow, and thus beyond his control. So there had occurred, by decedent's death, a disposition similar to what had occurred in the case of *Commissioner of Internal Revenue* v. *Linde,* supra, and, as noted by the Court in *Linde,* it was not necessary that there be a sale to establish income in respect of a decedent.

It is true that all of the conditions of the contract of August 4, 1960, had not been met by the date of Mr. Dinkler's death; however, those that remained unfulfilled have no material effect on these cases, as indeed they could not have been fulfilled until the closing date by the very nature of the contract itself. Many of these conditions precedent by their very nature were required to be performed on the day of closing.[3] Also, the management contract has no significant bearing since the evidence shows that by the date of decedent's death, the purchasers were not wedded to management by Carling Dinkler, Sr.

At the time of Mr. Dinkler's death, nothing was actually owed under the contract; however, he did possess a valuable right, namely, the right to the proceeds at the

closing in accordance with the terms negotiated by him. It is this right to the proceeds which the estate acquired solely as a result of decedent's death, and not by virtue of any economic activity of the estate.[4]

The many diverse characteristics in the various cases dealing with this statute do not permit an easy generalization, and we cannot draw from them a rule as to what is income in respect of a decedent in all cases. It is fair to say, however, in light of the development of the statute, that each of these characteristics represents an element in the composite concept that is income in respect of a decedent.

When the facts in these cases are all viewed, it is readily apparent that the proceeds in issue were realized as a consequence of negotiations and an enforceable contract made by Mr. Dinkler, Sr., during his lifetime, and not the result of any material acts or activities by the estate. The right to the proceeds was acquired by the plaintiffs solely by virtue of the death of the decedent and not through their own efforts. Had Mr. Dinkler lived through the closing date, the proceeds would have been income to him and, consequently, they constitute income in respect of a decedent when received by the estate. Accordingly, the action of the Commissioner in taxing these proceeds as such was proper.

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[3] The consent of the mortgagee was to be obtained by the purchasers, and the liquidation of Dinkler Hotels Company, Inc., together with the merger of Belvedere Corporation were likewise to be accomplished on or after the date of the closing.

[4] The participation by the estate in the loan made by the Trust Company of Georgia to Associated merely facilitated to some degree the closing of the contract negotiated by the decedent. The manner and method utilized by Associated, the purchasers, in assembling the necessary funds do not affect the rights of the parties to the contract as they existed on the date of death.

This opinion is adopted by the Court as the Findings of Fact and Conclusions of Law as provided by Rule 52(a), Federal Rules of Civil Procedure.

Judgment will be entered in each of these cases dismissing the complaints with prejudice and allowing the defendant his costs.

This the 9th day of December, 1966.

LEWIS R. MORGAN
United States District Judge

APPENDIX B

STATUTES INVOLVED

Internal Revenue Code of 1954:

"Sec. 691. **Recipients of Income in Respect of Decedents.**

"(a) **Inclusion in Gross Income.**

"(1) **General Rule.** The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period (including the amount of all items of gross income in respect of a prior decedent, if the right to receive such amount was acquired by reason of the death of the prior decedent or by bequest, devise, or inheritance from the prior decedent) shall be included in the gross income, for the taxable year when received, of:

"(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;

"(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

"(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right."

"(3) **Character of Income Determined by Reference to Decedent.** The right, described in paragraph (1), to receive an amount shall be treated, in the hands of the estate of the decedent or any person who acquired such right by reason of the death of the decedent, or by be-

quest, devise, or inheritance from the decedent, as if it had been acquired by the estate or such person in the transaction in which the right to receive the income was originally derived and the amount includible in gross income under paragraph (1) or (2) shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount."

"Sec. 1014. **Basis of Property Acquired From a Decedent.**

"(a) **In General.** Except as otherwise provided in this section, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be the fair market value of the property at the date of the decedent's death, or, in the case of an election under either section 2032 or section 811 (j) of the Internal Revenue Code of 1939 where the decedent died after October 21, 1942, its value at the applicable valuation date prescribed by those sections.

"(b) **Property Acquired From the Decedent.** For purposes of subsection (a), the following property shall be considered to have been acquired from or to have passed from the decedent:

"(1) Property acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent;"

* * * * * * * *

"(c) **Property Representing Income in Respect of a Decedent.** This section shall not apply to property which constitutes a right to receive an item of income in respect of a decedent under section 691."

REGULATIONS INVOLVED

Treasury Regulations on Income Tax (1954 Code):

"Sec. 1.691 (a)-1. **Income in respect of a decedent.**"

* * * * * * *

"(b) **General definition.**—In general, the term 'income in respect of a decedent' refers to those amounts to which a decedent was entitled as gross income but which were not properly includible in computing his taxable income for the taxable year ending with the date of his death or for a previous taxable year under the method of accounting employed by the decedent. See the regulations under section 451. Thus, the term includes:

"(1) All accrued income of a decedent who reported his income by use of the cash receipts and disbursements method;

"(2) Income accrued solely by reason of the decedent's death in case of a decedent who reports his income by use of an accrual method of accounting; and

"(3) Income to which the decedent had a contingent claim at the time of his death."

* * * * * * *

"Sec. 1.691 (a)-2 (b). **Inclusion in gross income by recipients.**"

* * * * * * *

"**Example (4).** A, prior to his death, acquired 10,000 shares of the capital stock of the X Corporation at a cost of $100 per share. During his lifetime, A had entered

into an agreement with X Corporation whereby X Corporation agreed to purchase and the decedent agreed that his executor would sell the 10,000 shares of X Corporation stock owned by him at the book value of the stock at the date of A's death. Upon A's death, the shares are sold by A's executor for $500 a share pursuant to the agreement. Since the sale of stock is consummated after A's death, there is no income in respect of a decedent with respect to the appreciation in value of A's stock to the date of his death. If, in this example, A had in fact sold the stock during his lifetime but payment had not been received before his death, any gain on the sale would constitute income in respect of a decedent when the proceeds were received.

"**Example (5).** (1) A owned and operated an apple orchard. During his lifetime, A sold and delivered 1,000 bushels of apples to X, a canning factory, but did not receive payment before his death. A also entered into negotiations to sell 3,000 bushels of apples to Y, a canning factory, but did not complete the sale before his death. After A's death, the executor received payment from X. He also completed the sale to Y and transferred to Y 1,200 bushels of apples on hand at A's death and harvested and transferred an additional 1,800 bushels. The gain from the sale of apples by A to X constitutes income in respect of a decedent when received. On the other hand, the gain from the sale of apples by the executor to Y does not.

"(2) Assume that, instead of the transaction entered into with Y, A had disposed of the 1,200 bushels of harvested apples by delivering them to Z, a cooperative association, for processing and sale. Each year the association commingles the fruit received from all of its members into a pool and assigns to each member a percentage interest in the pool based on the fruit delivered by him.

After the fruit is processed and the products are sold, the association distributes the net proceeds from the pool to its members in proportion to their interests in the pool. After A's death, the association made distributions to the executor with respect to A's share of the proceeds from the pool in which A had an interest. Under such circumstances, the proceeds from the disposition of the 1,200 bushels of apples constitute income in respect of a decedent."

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v.

AUBREY C. ROSS, DISTRICT DIRECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

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The question in this case is whether an estate's consummation of a contract of sale of corporate stock entered into by the decedent resulted in (Section 691 of the Internal Revenue Code of 1954) "income in respect of a decedent" measured by the difference between the sale price and the decedent's adjusted basis in the stock, or whether the transaction should be treated as a sale by the estate, with the basis stepped up to the fair market value of the stock on the day of death.

In October 1960, the decedent, Carling Dinkler, Sr., contracted to sell his stock interest in the Dinkler-Tutwiler corporation, a member of the Dinkler Hotel chain, to Associated Hotels corporation. The purchase price of $10,000,000 was payable partly in cash and the balance in notes. As the contract required, the decedent deposited with an escrow agent his stock certificate assigned in blank, and Associated deposited the $500,000 down payment with the agent. The sale contract contained usual provisions relating to warranty of title to the underlying assets of the corporation, adjustment of the price based upon a final audit, liquidated damages to the seller in event of default by the purchaser, right in the purchaser to cancel in event of default by the seller, and right in either party to cancel in case of destruction of the hotel property by casualty. The closing date, originally January 3, 1961, was subsequently extended to March 1, 1961. The decedent died on January 30, 1961. With some minor adjustments, the decedent's executor and Associated consummated the sale in February 1961. (Pet. App. A8-14).

The price exceeded the decedent's adjusted basis for the stock by $3,454,863. This amount was not reported as gain in either the income tax return filed on behalf of the decedent for the taxable period ending with his death, or in the estate's income tax return, or in the returns filed by the beneficiaries of the estate. The Commissioner determined that the gain constituted "income in respect of a decedent" taxable to the estate under Section 691(a)(1)(A) of the Internal Revenue Code 1954 (Pet. App. A15). In a suit

for refund of the resulting deficiency, the executor claimed a stepped-up basis on the theory that the estate acquired the stock from the decedent and then sold it to Associated. The district court sustained the Commissioner's determination (Pet. App. A16-A28). The court of appeals affirmed (Pet. App. A1-A5).

The decision is correct. No conflict exists, nor is any asserted; and there is no other reason for further review.

1. Section 691(a)(1)(A) of the 1954 Code provides that the "amount of all items of gross income in respect of a decedent" not includible in the taxable period ending with his death are includible in the gross income of his estate for the taxable year when received "if the right to receive the amount is acquired by the decedent's estate from the decedent".[1] The executor's "right to receive" the sale price stemmed from the decedent's execution of the sale contract.[2] But for the decedent's ownership of the stock and agreement to sell it, the executor's right to collect the contract price would never have arisen. As the court below observed (App. A5), the "contract created a right to these proceeds in Mr. Dinkler at the time the contract was executed", which "inured to and was binding upon his executor"; and while some

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[1] Section 1014(c) denies a stepped up basis to "property which constitutes a right to receive an item of income in respect of a decedent under section 691".

[2] Although the result would be the same whether the decedent or his executor made delivery of the stock, in this case the decedent also delivered the stock certificate, assigned in blank, to the escrow agent (Pet. App. A1).

acts remained to be performed by his executor, "these were not of such scope as would negate the right which was his under the contract".[3]

2. Petitioners' contention (Pet. 7-9) that the "right to receive" test embodied in 1954 Code Section 691 is tantamount to the narrow "accrued" income test contained in Section 42 of the Revenue Act of 1934 ignores the fact that the predecessor of the provision involved here was Section 126 of the 1939 Code, added by the Revenue Act of 1942.[4] Prior to 1934 income that had accrued to a decedent reporting on the cash basis escaped income taxation if it had not been collected during his lifetime.[5] To plug this loophole, Congress enacted Section 42 of the Revenue Act of 1934, which required accrued income of a decedent to be included in his last return.[6] This provision sometimes produced hardship by bunching in the decedent's last return income collectible over a period of several years, thus subjecting it to higher tax rates.

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[3] Although the court of appeals considered the test applied by the district court ("whether the post death payments are in fact due to the services performed by or the economic activities of the decedent") as somewhat broad, it held that the district court "reached the correct result", and that its decision "in effect, is based on the right to income test; it simply was not articulated as such". (Pet. App. A2, 4).

[4] For a history of the provisions governing income in respect of a decedent see *e.g.*, *Davison's Estate* v. *United States*, 292 F. 2d 937 (Ct. Cl.); *Richardson* v. *United States*, 294 F. 2d 593 (C.A. 6), certiorari denied, 369 U.S. 802.

[5] See *Helvering* v. *Enright*, 312 U.S. 636; *Nichols* v. *United States*, 64 Ct. Cl. 241, certiorari denied, 277 U.S. 584.

[6] See *Estate of Putnam*, 324 U.S. 393.

Accordingly, the 1942 Act added Section 126 to the 1939 Code substituting for the "accrual" concept embodied in the prior law the broader "right to receive" criterion, and requiring the income to be reported when collected by the person who acquired from the decedent the right to receive it. The result was to (H. Rep. No. 2333, 77th Cong., 2d Sess. 83 (1942)):[7]

> change * * * existing law by providing that such amounts shall not be included in the decedent's income but shall be treated, in the hands of the persons receiving them, as *income of the same nature and to the same extent as such amounts would be income if the decedent remained alive and received such amounts.* [Emphasis added.]

3. In harmony with the language and history of 1954 Code Section 691, the Treasury Regulations make it plain that the phrase "right to receive" is not to be assimilated to income "accrued" in the technical accounting sense, but refers to income to which the decedent would have been entitled had he remained alive and received it. See Regulations Section 1.691 (a) under the 1954 Code.[8] Indeed, the Regulations expressly provide that "income in respect of a dece-

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[7] See also *Commissioner* v. *Linde,* 213 F. 2d 1 (C.A. 9), certiorari denied, 348 U.S. 871; *Davison's Estate, supra.* Petitioner's quotation from Mertens (Pet. 8) regarding "prior law" has reference to 1939 Code Section 126 (added by the 1942 Act), which was substantially the same as 1954 Code Section 691 here involved, not (as petitioners imply) to Section 42 of the 1934 Act, which differed from both.

[8] The Regulations were adopted October 7, 1957. T.D. 6257, 1957-2 Cum. Bull. 342.

dent", as that term is used in Section 691, embraces "[i]ncome to which the decedent had a contingent claim at the time of his death" (Section 1.691(a)-1(b)(3))—a far more comprehensive standard than that determinative of when income "accrues" under orthodox accrual accounting principles.[9]

4. The courts have uniformly held that Section 691 (and Section 126 of the 1939 Code) applies not only to amounts owing to the decedent at the time of his death, but also to amounts which would have been income to him had he lived to collect them. *Commissioner* v. *Linde*, 213 F.2d 1 (C.A. 9), certiorari denied, 348 U.S. 871; *Davison's Estate* v. *United States*, 292 F.2d 937 (Ct. Cl.); *Riegelman's Estate* v. *Commissioner*, 253 F.2d 315 (C.A. 2); *O'Daniel's Estate* v. *Commissioner*, 173 F.2d 966 (C.A. 2); *Bausch's Estate* v. *Commissioner*, 186 F.2d 313 (C.A. 2); *Keck* v. *Commissioner*, 49 T.C. 313; *Bernard* v. *United States*, 215 F.Supp. 256 (S.D.N.Y.). In some of these cases (*e.g.*, *Linde*, *Davison*, *Keck*, *Riegelman*, *Bernard*) conditions pre-

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[9] Example (4) in the Regulations (Section 1.691(a)-2(b)), upon which petitioner relies (Pet. 11), is inapposite here since it poses a case where the decedent "agreed that his executor would sell" his stock and the shares were "sold by [the] executor". Here the decedent did the selling and the situation falls within the last sentence of the example ("If, in this example, A had in fact sold the stock during his lifetime but payment had not been received before his death, any gain on the sale would constitute income in respect of a decedent when the proceeds were received.")

Nor does example (5)(1) aid the petitioners; it poses only a case where the decedent had "entered into negotiations to sell * * * but did not complete the sale before his death". Compare example (5)(2).

cedent to payment remained to be performed and no specific sum was owing to the decedent at his death. In others (*e.g., O'Daniels*), the decedent did not even have a legally enforceable right to the payment, which was deemed income with respect to the decedent because they were (173 F.2d at 968) "expectancies which later bore fruit." [10]

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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JULY, 1968.

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[10] Neither *Eisner* v. *Macomber*, 252 U.S. 189, nor *Lucas* v. *North Texas Co.*, 281 U.S. 11, cited by petitioners (Pet. 12-13), has anything to do with income in respect of a decedent. *Macomber* held that a common stock dividend in proportion to common stock holdings did not result in a realization of gain to the stockholders because there was no severance of income from capital; here gain was plainly realized in the amount of the difference between the sale price and the basis of the stock. *North Texas* held only that gain on a sale of property should be reported in the year of the sale, and not in the earlier year when the buyer informed the seller that an option would be exercised.

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Petitioners,

v.

AUBREY C. ROSS, District Director of Internal Revenue,
Respondent.

PETITIONERS' REPLY TO RESPONDENT'S MEMORANDUM IN OPPOSITION TO GRANTING OF PETITION FOR A WRIT OF CERTIORARI.

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AUBREY C. ROSS, District Director of Internal Revenue,
Respondent.

PETITIONERS' REPLY TO RESPONDENT'S MEMORANDUM IN OPPOSITION TO GRANTING OF PETITION FOR A WRIT OF CERTIORARI.

Respondent's opposition is based on the assertion that the decision below is correct and that no conflict exists. Petitioners concede that the decision below does not conflict with the decision of any other Court of Appeals, and have never asserted that it does. But it does conflict with a basic principle laid down by this Court thirty-eight years ago.

I. The Failure of the Court of Appeals to Follow Decisions of This Court.

Respondent's memorandum does not deal at all with Petitioners' showing that the Court of Appeals has decided a federal question in such a way that it is in

conflict with applicable decisions of this Court, **Eisner v. Macomber**, 252 U. S. 189 (1920) and **Lucas v. North Texas Lumber Company**, 281 U. S. 11 (1930). Respondent dismisses those cases by a footnote statement that neither of them "has anything to do with income in respect of a decedent." These cases stand for the two propositions for which they are cited, namely (1) that gain from a capital investment does not occur through growth or increment in value of that investment, but only on realization of a "gain, a profit, something of exchangeable value proceeding from the property" and (2) more specifically, that the unconditional liability of the vendee under an executory contract for the purchase of property does not arise until a tender of **title and the right to possession** is made to the vendee or the transaction is closed. From this it follows that the vendor's right to receive the purchase price does not arise until the same events have taken place.

To support Respondent's assertion that the decision below is correct, he construes section 691 as meaning that since the right received by the executor from the decedent "stemmed from the decedent's execution of the sale contract" it is taxable under that section. Respondent says (Memo. p. 3), "But for the decedent's ownership of the stock and agreement to sell it, the executor's right to collect the contract price would never have arisen." This is another way of stating the ground on which the trial court decided the case, namely that the test is whether the income was the product of decedent's economic activities. However, this test was repudiated by the Court of Appeals, which correctly stated that, in order to be taxed under section 691, the income collected by the executor must be income which the decedent had a right to receive at the time of his death. The error of the Court of Appeals was in its conclusion that the decedent had a right to receive the amount which later came to the

executor, pursuant to an amendment of the sale contract, negotiated by the executor after decedent's death. That conclusion is squarely in conflict with this Court's decision in **Lucas v. North Texas Lumber Company**, *supra*, and with the principles announced in **Eisner v. Macomber**, *supra*.

Respondent cites (Memo. p. 6) seven cases as supporting the statement that section 691 applies "not only to amounts owing to the decedent at the time of his death, but also to amounts which would have been income to him if he had lived to collect them." Of these seven cases, **Davison's Estate v. United States**, 292 F. 2d 937 (Ct. Cl. 1961), cert. denied, 368 U. S. 939 (1961), involved rents due for a period prior to decedent's death; **Riegelman's Estate v. Commissioner**, 253 F. 2d 315 (2d Cir. 1958), **O'Daniel's Estate v. Commissioner**, 173 F. 2d 966 (2d Cir. 1949), **Bausch's Estate v. Commissioner**, 186 F. 2d 313 (2d Cir. 1951), and **Bernard v. United States**, 215 F. Supp. 256 (S. D. N. Y. 1963), all involved compensation for personal services fully performed by the decedent prior to his death; and **Commissioner v. Linde**, 213 F. 2d 1 (9th Cir. 1954), cert. denied, 348 U. S. 871 (1954), was a case in which a sale was completed and the property delivered to the buyer prior to death. Only the decision in **Keck v. Commissioner**, 49 T. C. 313 (1968), by the Tax Court bears any relationship to the issue in the instant case. As we have heretofore pointed out, the Tax Court there based its decision, over the vigorous dissent of five of its members, on the "economic activities" test which the Court of Appeals has here repudiated. The distinction between rents and compensation for personal services on the one hand and of gains from sales, resulting from appreciation over a number of years, was recognized in **Helvering v. Enright**, 312 U. S. 636 (1941), where the Court confined its decision to **"the value of the services rendered by the decedent."**

While **Enright** added a gloss to the normal accounting meaning of "accrued" as used in section 42 of the Revenue Act of 1934, this gloss at the time Section 126 was enacted in 1942 was limited to corporate compensation and partnership income cases where the decedent clearly completed his services to his corporate employer or his partnership at the time of his death with no act left for the executor to perform. Such gloss had certainly not included as accrued income the gain from an executory contract to sell unperformed at the decedent's death. In attempting to bridge this unbridgeable gap, the Respondent has wrenched a portion of the House of Representatives Ways and Means Committee Report from its context in an effort to make it appear that the predicate—"income accrued up to the date of his death"—did not exist. The portion quoted refers back to that predicate by the use of the phrase "such amounts." The same clear reference back also appears earlier in the same paragraph with the use of the words "such income," referring to "income accrued up to the date of his death."

II. The Conditional Nature of Decedent's Contract.

Respondent says (Memo. p. 2) that "with some minor adjustments, the decedent's executor and associates consummated the sale in February 1961." The inference is that the "minor adjustments" did not affect the Petitioner's "right to receive." **North Texas** cannot be distinguished on that ground. In that case, an executory contract to sell was entered into in 1916, and the purchaser declared itself ready to close the transaction "as soon as the papers were prepared." The papers in question which were not prepared and delivered until the following year were described as "the written instruments which were required to complete the transfer." 7 B. T. A. 1193, at 1196. In short, the only condition remaining at the end of 1916 was preparation, delivery and

acceptance of a deed to the property. During the thirty-eight years since the **North Texas** decision, similar issues have arisen where the right to receive proceeds of sale were of a similar nature, and the **North Texas** rule has always been applied. **Bourne v. Commissioner**, 62 F. 2d 648 (4th Cir. 1933), cert. denied, 290 U. S. 650 (1933); **Commissioner v. Segall**, 114 F. 2d 706 (6th Cir. 1940), cert. denied, 313 U. S. 562 (1941); **Chapin v. Commissioner**, 180 F. 2d 140 (8th Cir. 1950).

Under the contract which decedent signed, many conditions remained to be met at the time of his death before there would be any "right to receive," in addition to the preparation of documents of transfer. See Petitioners' brief at pages 4 and 5. One of the most important was the production, at closing, of $6,215,000 in cash in addition to the $500,000 of earnest money. When the time to close approached, it developed that the purchaser did not have the required funds and was unable to borrow the full amount from first line sources. The executor, following extended negotiations, agreed to change the contract provisions, by accepting only $5,715,000 in cash at the closing and increasing the purchaser's note by $500,000. Without the $500,000 amendment there would have been no $2,000,000 loan by the Trust Company of Georgia (R. Vol. I, 111). The executor's right to receive the proceeds of sale, therefore, was not fixed by the decedent's contract but by this new contract of the executor. If the executor had refused to alter the terms of the contract and if the purchaser—a new corporation with only $45,000 of paid-in capital—had defaulted, all the parties to the executory contract would have received only the $500,000 of "earnest money" of which Petitioners' share would have been less than one-third (31.6%). The right to receive that sum, though stemming from the original contract, would not have come into being until the purchaser's failure to perform.

CONCLUSION.

Because of the failure of the Court of Appeals to respect a decision of this Court which has been followed for thirty-eight years, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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